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BEFORE THE

HOUSE SUBCOMMITTEE ON INVESTIGATIONS AND OVERSIGHT

REGARDING AIR CARRIER FITNESS

NOVEMBER 17, 1987

Mr. Chairman, Members of the Subcommittee, I appreciate being offered this opportunity to discuss the Department's air carrier initial and continuing fitness programs and the recent improvements made to these programs. I will also provide a status report on the Galaxy Airlines continuing fitness case in which some of you have expressed an interest.

Let me begin by briefly reviewing our procedures for issuing a certificate of public convenience and necessity, and authority to operate as a commuter air carrier.

Initial Fitness

Under the Federal Aviation Act, anyone seeking authority to conduct operations as a certificated or commuter air carrier must be found to be a U.S. citizen as well as "fit, willing and able" to conduct the services proposed.

The Department uses a three-part test to determine the fitness of a company. First, we examine the experience and competence of an applicant's key employees to determine whether they possess the business and technical knowledge to run an airline of the size and complexity proposed. Second, we review a company's operating and financial plans to gauge the applicant's understanding of the costs associated with entry into the airline industry and discover whether the applicant will have the necessary funds to allow the company to begin operating without posing an undue risk to consumers or their funds. Third, we study the compliance record of an applicant to ensure there is no history of violations of laws or regulations that may lead the Department to doubt that the carrier would comply with state or federal laws, rules and directives.

If we determine that an application is complete, find no inaccuracies or misrepresentations, and the applicant appears to be fit, we issue an order tentatively finding the applicant fit and ask interested persons to provide us with any reasons why the Department should not finalize a fitness determination. If no responses are filed, a final order is issued. However, if there are objections, we, of course, review the information submitted before making a final decision. These decisions must then discuss any significant objections received.

If a company has received the required operating authority from the FAA and all necessary financing, we will issue an effective certificate or commuter registration with our final order. If, on the other hand, the company must complete various important steps before being ready to operate, we may issue a fitness finding but condition the effectiveness of the authority upon the carrier's completion of these steps.

In cases where there are substantial unresolved questions of fact concerning a carrier's fitness, other procedures come into play. These may include an oral evidentiary hearing before an administrative law judge. Oral hearing procedures are costly to the applicant as well as the Department, and are employed only in those cases where written procedures are not adequate.

Continuing Fitness

Carriers which have been found fit and awarded a certificate or commuter authority are subject to the continuing fitness requirement set forth in section 401(r) of the Act. That section instructs DOT to modify, suspend, or revoke the authority of a carrier if it fails to maintain its fitness or supply the information needed by the Department to determine whether the carrier has maintained its fitness. We have developed a system for carrying out this responsibility which includes first, the routine receipt and review of information from a variety of

sources. This includes information both from Department sources and from external sources. DOT sources include reports from the FAA concerning major enforcement actions; reports from our Office of Consumer Affairs on denied boardings and consumer complaints for individual carriers; reports from our Research and Special Programs Administration on carriers that are delinquent in filing Form 41 data and other required reports including the status of any related enforcement actions; and periodic reports from other offices which deal with air carrier issues on any observed air carrier problems. Other relevant information may come from external sources such as press reports and interested persons including employees, competitors and creditors.

Where an analysis of the data shows that a carrier has undergone substantial changes that may affect its fitness, or where actual fitness problems are perceived, a further fitness review is undertaken. Such a review would include the gathering and analysis of information already in the Department's possession relating to the carrier, such as Form 41 financial and traffic reports and the FAA's Aviation Safety Analysis System (ASAS) data on the company's accidents, incidents, and enforcement records. Frequently, a further check is made with FAA personnel familiar with the carrier's operations to determine whether our information is up to date and whether there are other factors bearing on the carrier's fitness. Where appropriate, information is sought from other government sources such as State Attorneys General, the Securities and Exchange Commission, and Bankruptcy Court

officials. Although this review may be sufficient to answer our concerns in most cases, a certified letter is sent to the carrier requesting additional specific information deemed necessary to resolve our concerns. A copy of the letter is sent to the FAA. Depending upon the response of the carrier, two paths of action are available to us.

If a reply is received from the carrier, it will be analyzed together with the data already compiled. Once adequate information is received, we frequently find that the carrier remains fit and no further procedures are warranted. In such cases, a memorandum is prepared for the files summarizing the pertinent information reviewed and the basis upon which the decision to terminate the review was reached. A letter is sent to the carrier and the FAA indicating that the review has been completed and no action is contemplated.

If the carrier does not respond, or if the response does not satisfy the concerns raised by the information-request letter, an order establishing more formal procedures may be issued. Most frequently, the procedure chosen is a show-cause proceeding in which DOT proposes to suspend or revoke a carrier's certificate. Another option, of course, is the institution of a formal investigation which may include an oral evidentiary hearing.

As some here today know, this latter option was selected in the case of Galaxy Airlines. I'll review the status of that proceeding for you in a moment, but first I would like to outline a number of important developments in our fitness and certification program which have taken place since the Department last appeared before this panel to discuss our fitness procedures.

Changes in fitness program

Possibly the most important change that has come to our program is the adoption of a new regulation which provides for the automatic revocation of a certificate or commuter authority if the carrier holding that authority is dormant for a 12-month period -- either because it never began operating or because the carrier ceased providing service. The rule became effective on December 8, 1986. The carriers which were dormant as of that date will lose their authority on December 8, 1987, unless they have begun operations or filed for a redetermination of their fitness in accordance with our rules by December 8th of this year. Approximately 60 dormant carriers stand to lose their authority under this rule.

This regulation also has another very important provision. Carriers which cease operations for any reason must have their fitness redetermined by the Department before they can resume service. Unless granted an exemption from the requirement, such carriers must file information with the Department supporting

their continuing fitness at least 45 days before they propose to resume operations. In cases where a carrier ceases operations for a brief period for reasons which do not reflect negatively on fitness, exemptions are normally granted. In such cases, the process can be completed quickly and imposes little burden on the carrier. However, in cases where the cessation extends for a substantial period, or if the circumstances cast doubt on the company's fitness or ability to perform its proposed services, an in-depth fitness review is undertaken. These fitness redeterminations are normally processed by show-cause procedures, that is, without oral evidentiary hearings.

Prior to our institution of this rule, carriers could recommence operations without first demonstrating their fitness to do so. While the Department could institute a continuing fitness proceeding, the operations could continue until a final order was issued.

A second area of improvement involves our fitness criteria. The Department has both tightened and more clearly enunciated the guidelines it applies when reviewing applications for authority to commence or resume air transportation operations. For example, non-operating carriers are normally asked to demonstrate that funding is available which, at a minimum, equals pre-operating costs plus three months of estimated operating expenses. Approved loans or lines-of-credit are counted in this test, but forecast revenues are not. The guideline is seldom applied inflexibly, but exceptions are made only if good cause is shown. This stricture

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has been set forth in our show-cause and final orders, which receive wide circulation, so that future applicants may have a better idea of our expectations.

During the past two years, we have also been applying firmer criteria when reviewing the qualifications of a company's management team. Although the number of the employees and kinds and levels of experience required will vary with the scale and complexity of operations proposed, we have been unwilling to grant effective authority to carriers which do not have an adequate management team. Further, in a recent case where a commuter applicant proposed to operate an unusually small-scale operation with part-time management, we limited the extent of the authority granted until such time as the carrier could demonstrate that it had obtained adequate full-time management personnel.

The general tightening of the criteria applied in fitness determinations has also been extended to the area of compliance disposition. In the past, carriers which were not in compliance with our regulations on a consistent basis, including most particularly our recurrent financial and traffic reporting regulations, were sometimes granted additional authorities. We now withhold such additional authorities until the company demonstrates compliance with our regulations and we are able to find that it is likely to comply in the future.

In addition, a number of applicants have misrepresented their safety and compliance histories by failing to report all of the accidents, incidents, or FAA enforcement proceedings in which they have been involved. We view these as serious lapses and a reason to deny a company the fitness finding and additional authority it seeks. Where appropriate, we have deferred action on an application for a period sufficient to allow the company to demonstrate its improved compliance attitude.

During the past two years, the Department has improved its fitness program by increasing the resources devoted to this important function through the transfer of personnel from within OST to the Air Carrier Fitness Division, which handles 90 percent of all fitness work. Upon the CAB's sunset in 1985, the Division had only four analysts. OST increased that number to six in 1986 and, at present, there are nine analysts. The increase in staffing has accompanied an increase in emphasis on the continuing fitness rather than initial certification program.

In addition to increasing the staffing levels, we have also been striving to provide crucial support and tools that will increase the effectiveness of the existing staff. We have done this by working more closely with other offices and agencies and by increasing our use of computerized information sources. Our fitness staff has obtained direct access to the FAA's Aviation

Safety Analysis System and is working with the FAA and Department of Defense on a new information and analysis tool, the Air Carrier Analysis System, commonly referred to as "ACAS,"

A prototype of this system is currently in place. Briefly, ACAS is being developed on behalf of DOD to improve its ability to identify and act upon potential safety problems of carriers serving DOD. The system utilizes safety and compliance data available from FAA's data bases; financial data available from the Form 41 filings with DOT; information available from private data bases, such as Dun and Bradstreet; and information from performance evaluations conducted by DOD staff.

We are optimistic that, when completed, ACAS will not only aid DOD in fulfilling its goals, but also will prove a valuable resource for carrying out the continuing fitness responsibilities of OST. The Acting Secretary has signed a memorandum of understanding between the Department and DOD which, among other things, commits the Department to cooperate in developing this interdepartmental data base.

Currently, senior staff members from both FAA and OST serve on the ACAS working group and are actively involved in the development of this system. Several other staff members have undergone training in the use of this system and are participating in the final evaluation of the prototype.

In addition to the joint development of ACAS, OST regularly provides information to DOD regarding that agency's contract carriers prior to DOD's own performance evaluations. The information provided alerts the DOD survey team to any financial problems or changes occurring with the carrier and enables DOD to conduct a more thorough examination of the carrier's operations. Further, if, as a result of these performance evaluations or other dealings with the carrier, DOD discovers possible fitness problems with a particular carrier, it notifies OST thereby aiding us in the performance of our continuing fitness function.

Galaxy Airlines Status

As you know, subsequent to the fatal crash of a Galaxy aircraft in Reno, Nevada, on January 21, 1985, the Subcommittee expressed concern about the CAB's handling of the company's initial certification and DOT's monitoring of Galaxy's continuing fitness as a certificated carrier. At the Subcommittee's request during hearings in June 1985, the Department, through its Office of Inspector General, sought to determine Galaxy's current financial posture and to resolve the issue of whether or not Galaxy's owner, Mr. Phillip Sheridan, had divested himself, as reported, of all ownership and controlling interests in two aviation-related companies he owned prior to purchasing Galaxy.

As a result of the Office of Inspector General's investigation, serious questions about the carrier's financial fitness and compliance disposition were revealed.

To resolve these issues, the Department, in April 1986, instituted the Galaxy Airlines, Inc., Continuing Fitness Investigation, and directed the carrier to provide fitness-related information in response to an extensive evidence request. When the information we received proved to be unsatisfactory, the Department, in September 1986, assigned the case to an Administrative Law Judge for an oral evidentiary hearing, and again directed the carrier to provide fitness-related information in response to yet another extensive evidence request. In November 1986, the bulk of Galaxy's response was received, although other submissions have followed since that time.

Circumstances continued to change at Galaxy, however, which caused delays in the hearing process. For example, the Department was notified that Galaxy was sold to a group of investors in December 1986, changing certain of the fitness information already received in the case. The sale fell through in February - March 1987, further altering the circumstances.

In March 1987, Galaxy ceased operations and its air carrier insurance was cancelled due to non-payment of premiums. The

Department notified the carrier by cable on April 15, 1987, that its certificate was automatically suspended pursuant to section 204.8 of our rules based on its cessation of operations and its failure to maintain air carrier insurance as specified by the Act. Although Galaxy filed an emergency exemption application requesting that the Department lift the suspension, that request was denied. Galaxy, in turn, challenged both the suspension action and the denial of the exemption request in an action filed in the Eleventh Circuit Court of Appeals. On September 2, the court dismissed the suit for lack of jurisdiction.

In May 1987, the Department was advised that Galaxy was being sold again. In July of this year, the new owners filed Galaxy's second emergency exemption application requesting that the Department lift the suspension and permit the carrier to recommence operations. On August 20, 1987, shortly before the continuing fitness hearing was scheduled to begin, the Department issued an order staying the continuing fitness investigation to allow more time to review the exemption application and to resolve certain issues involving the new owners.

Most recently, the Department has been advised that there is a question of actual majority ownership of Galaxy among the new owners. Moreover, the Department recently learned that two of Galaxy's key personnel, its Director of Operations and Chief Pilot, have resigned.

Last week, we issued an order in the Galaxy case denying its request to recommence service. We found that questions about its fitness still remained. To expedite review of Galaxy's fitness, we established special procedures and prepared a list of questions for Galaxy to answer.

The carrier has until December 14th to respond to our information request.

Since the Galaxy case is pending before us for decision, I cannot discuss the merits of the application. However, I will be happy to answer any other questions the Subcommittee may have on the Department's fitness program.